

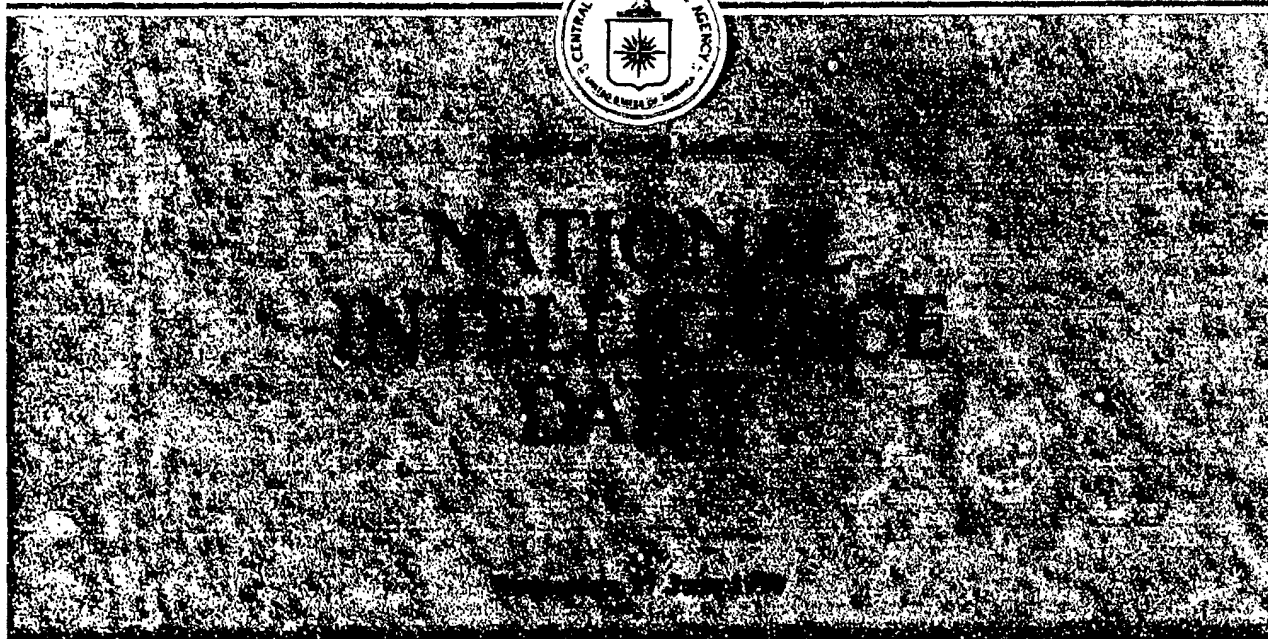
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USSR:

Leadership Defending Security Policies

As the Soviet Party Congress approaches, the Politburo is increasingly defensive about charges from traditionalists that it has bungled policy on arms control and Eastern Europe.

In yesterday's *Pravda*, Foreign Minister Shevardnadze defended his Ministry and its policies and attacked critics in the military and defense industries. He said that the General Staff is the center for elaborating arms control policy and that the MFA has only one seat in the group making decisions. Shevardnadze pointedly compared discussion of "who lost Eastern Europe" to the McCarthy era and the "who lost China" debate in 1949.

Minister of Defense Marshal Yazov agreed in this morning's *Pravda* with Shevardnadze's account of decisionmaking. Moreover, Politburo member Zaykov, who is the party secretary responsible for oversight of the armed forces, insisted recently in *Pravda* that Soviet arms control policy is not the product of President Gorbachev's vanity or established to please foreign audiences but is set through broad debate among military and civilian specialists.

In a speech to military cadets yesterday, Gorbachev praised the army's selfless defense of the homeland but forcefully defended the need for military reforms to reduce budget outlays and to end "negative phenomena" in army life. In its report on the meeting, TASS for the first time in several months identified Gorbachev as the head of the Defense Council.

Comment: Gorbachev and other Politburo members are trying to defuse criticism of their security policies that is sure to be raised next week at the party Congress. Traditionalist criticism of Gorbachev's security policies has been growing at party Central Committee plenums since December, and senior military officers raised arms control, East European, and domestic security issues at the recent Russian party congress. Gorbachev's ability to parry their attacks at the Congress will determine their impact on policy on arms control, Germany, and the Baltic republics.

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Status of the Embargo on Lithuania

Lithuania's economic situation remains largely unchanged since Moscow's announcement two weeks ago of several measures to ease the embargo, but Vilnius is increasingly concerned about the impact on the harvest of a shortage of fuels and lubricants.

Moscow promised to review the issue of supplying fuel for agriculture but has not announced a decision. A dry spring has helped Lithuania by delaying crop growth somewhat, but the lack of fuel for farm machinery could drastically reduce the harvest of grain and other food crops, which should begin by late next month:

- Vilnius estimates that it will run out of engine lubricating oil and gasoline for agricultural machinery by early next month and that stocks of diesel fuel will last until midmonth.
- Haying, which continues through the summer and produces essential feed for the meat and dairy industries, is lagging because of a fuel shortage.
- Harvest support from unemployed people and students and the use of hand tools and horsedrawn machinery will not compensate for the loss of mechanized equipment.
- Shortages of fuel for transportation are slowing distribution of agricultural products and other goods to processing centers and markets.

Industrial output appears to have stabilized; the numbers of unemployed workers and closed plants has not changed significantly for several weeks. Moscow has made good on its promise to increase the supply of natural gas; Lithuania is receiving about 10.5 million cubic meters of natural gas per day, nearly normal supplies for this time of the year:

- The Jonava fertilizer plant, which uses natural gas as feedstock, reportedly is operating at current full capacity.
- Lithuania has received less than half its usual monthly supply of bottled gas, however, which is used primarily in rural households.
- There is also no evidence available that the supply of raw materials to plants subordinated to the republic has increased as Moscow promised.

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USSR:

Gorbachev Shows New Flexibility on Lithuania

The Soviet leader appears to be softening his position on Lithuania, increasing the possibility that the republic's legislature will take steps that get independence talks under way.

Premier Prunskiene yesterday told the Lithuanian legislature Gorbachev had telephoned her and had said that, to get independence talks started, he was willing to accept a moratorium on the republic's independence declaration as defined recently by the Lithuanian Council of Ministers. In urging its legislature to consider the moratorium, the republic government had emphasized that such a move would preserve Lithuania's independent status during negotiations and, [redacted] would not entail acceptance of Soviet law. [redacted]

Before calling Prunskiene, Gorbachev met with Lithuanian President Landsbergis, who laid out several variants of the moratorium proposal to be debated by the republic legislature. In a subsequent speech to the legislature, Landsbergis described Moscow as newly flexible but said he still wants guarantees about the consequences of a moratorium. A Lithuanian spokesman said yesterday the legislature decided to postpone debate on the variants until tomorrow to study options. [redacted]

Comment: Gorbachev's acceptance of a moratorium that leaves Lithuanian legal independence intact would mark a major concession by allowing the Lithuanians to exempt themselves from the law on secession. He may have decided to soften his position in part because of promises of support for the Baltic causes from Russian Republic Chairman Yel'tsin and liberal governments in Leningrad and Moscow. He and his advisers also seem increasingly convinced they need Western economic aid and probably believe such help will be severely limited if they stick to a hard line in the Baltic region. [redacted]

Gorbachev's new flexibility increases the chances the Lithuanian legislature will adopt some kind of moratorium declaration. Most Lithuanian legislators, however, are likely to share Landsbergis's concern about guarantees. Thus, any declaration probably would link the onset of a moratorium to Moscow's official acknowledgment that Soviet law is not in force in the republic. [redacted]

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New Power Centers in the Ukraine

The Democratic Bloc, an electoral slate made up of Rukh, the Helsinki Union, the Union of Independent Ukrainian Youth, the Green Movement, and other grassroots groups, this spring won 20 to 25 percent of the seats in the new 450-member republic legislature. The Bloc delivered solid proindependence majorities to city soviets (councils) in L'vov, Ternopol, and Ivano-Frankovsk in the western Ukraine.

The non-Communist governments there are now moving to strip the local Communist Party—the second-largest organization in the USSR and still the ruling power in the southern, eastern, and rural areas of the Ukraine—of its power and property and are pushing for an independent Ukrainian state.

The Bloc also commands a third of the seats in the Kiev city soviet. As in the republic-level legislature, it is not strong enough to impose its own will but is able to block the party-dominated majority. In a victory for the Bloc, the party was forced to compromise on the candidate for Kiev's mayor last month; it chose a reformer instead of the apparatus candidate.

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USSR:

Politics Shifting in the Ukraine

The election of hardliner Stanislav Gurenko as first secretary of the Ukrainian Communist Party leaves Supreme Soviet Chairman Vladimir Ivashko freer to play a centrist role in the republic but may strengthen a traditionalist trend in the national party.

The Ukrainian Communists showed a deeply conservative mood by choosing Gurenko, who had close career ties to former party boss Shcherbitskiy and often sided against reform. The size of the margin—80 percent voted for Gurenko—and the tenor of the speeches at the congress made clear the depth of resentment over the party's declining power. Regional party leaders assailed Gorbachev and his Politburo allies Yakovlev and Medvedev for leading the party and the economy into crisis.

Ivashko resigned as head of the Ukrainian party after becoming chairman of the republic's Supreme Soviet. Opposition to his holding both top posts had come from the Ukrainian popular movement, Rukh, which controls 25 percent of the legislature, and from independent deputies in the legislature. (C NF)

Both party officials and Rukh leaders see Ivashko as a centrist. An editor of a reformist youth paper recently said his position was similar to Gorbachev's, only worse. New Deputy Chairman of the Supreme Soviet Grinev, who was elected as Ivashko's compromise candidate to mollify the party's reform wing, doubts reform of the party is possible.

Comment: Ivashko now has a freer hand to pursue Ukrainian autonomy and reform of the republic's government. He will try to create a stable power center in the legislature, which is split along factional, regional, and ideological lines. He will find it hard, however, to reconcile traditionalists and the reformist opposition.

Gurenko's election probably will speed the exodus from the party of Communist members disheartened at the lack of democratic reform and will make the party even more a bastion of traditionalists. Rukh leaders and many of their supporters have already quit to form independent parties, and members of the Democratic Platform and many Donbass miners have threatened to follow.

The Ukrainian events will have national reverberations. Gurenko's election may further embolden traditionalists in other republics, and Ivashko's decision to give up his party post may increase pressure on Gorbachev to follow suit.

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POLAND:

Energy Price Hikes May Help Walesa

Impending energy price increases may hand Lech Walesa a ready weapon in his campaign to claim the political heritage of Solidarity and gain the Polish presidency.

Solidarity activists favoring Prime Minister Mazowiecki's policies split with Walesa after a bitter debate at a meeting of the National Citizen's Committee on Sunday. Delegates from the largely autonomous regional Citizen's Committees will meet this weekend, with both factions vying for support.

Walesa met recently with leaders of the Peasant and Democratic Parties, Solidarity's coalition partners in the legislature. A regional Rural Solidarity official said his organization was aligning with Walesa to protest Warsaw's farm policies.

Polish Primate Cardinal Glemp has issued a vague endorsement of the "Center Accord," a body that aides to Walesa created to advance his presidential campaign.

Meanwhile, Warsaw is moving ahead with plans to raise prices for electricity and natural gas by 80 to 100 percent on Sunday.

Comment:

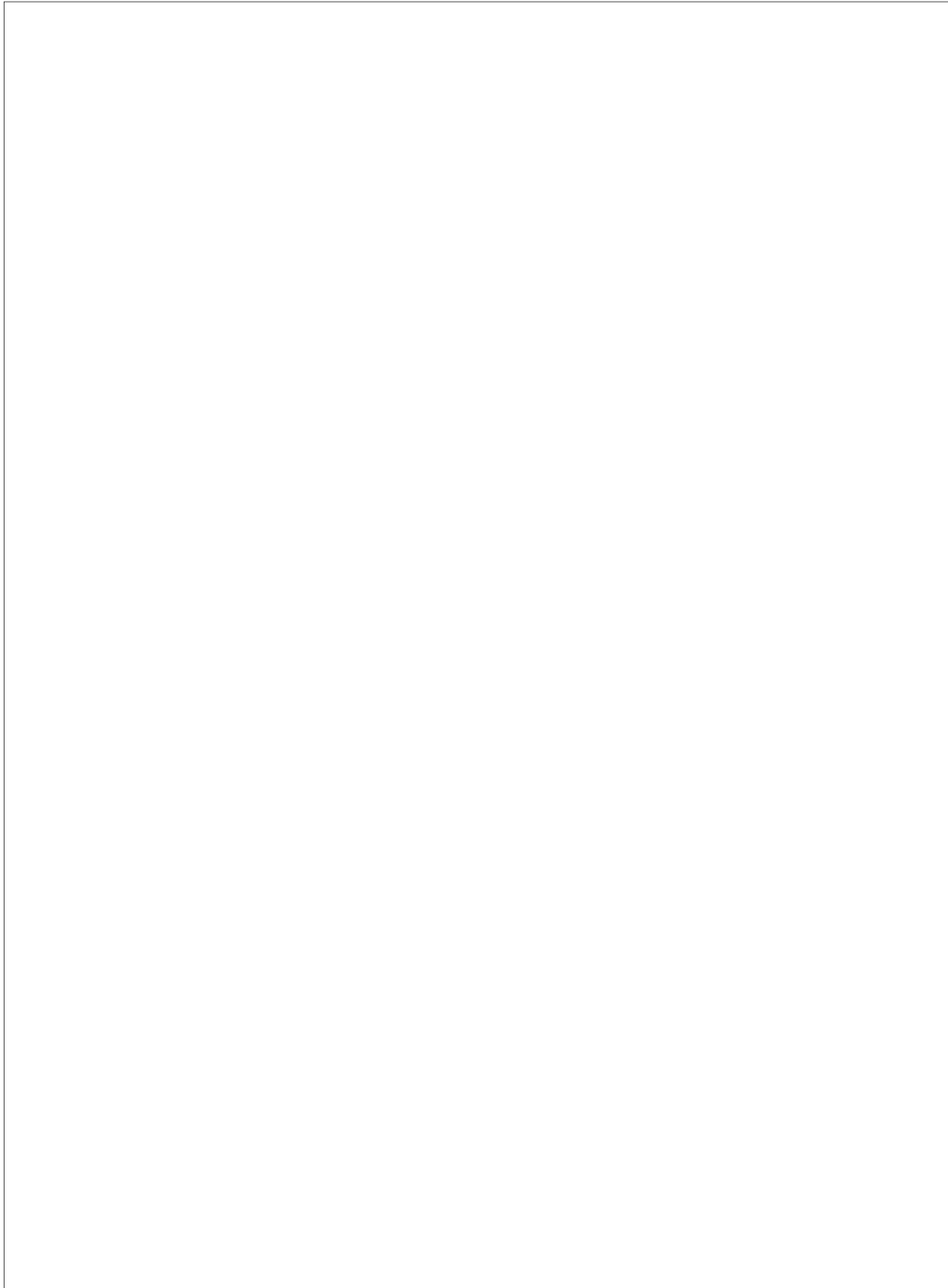
growing labor restiveness and Solidarity infighting heighten the possibility of widespread opposition to the price increases. Such a development would help Walesa press his case that faster political change, including his own move to the presidency, is essential to maintain support for economic reform.

Mazowiecki is unlikely to withdraw the price reforms, which the government believes are necessary to promote conservation and industrial restructuring, but he probably will feel compelled to relax wage controls further. He may also be close to abandoning efforts to delay a Walesa presidency. Walesa's maneuvering with the government's coalition partners creates uncertainty about the government's ability to maintain a parliamentary majority and the viability of a Mazowiecki government in tandem with a Walesa presidency.

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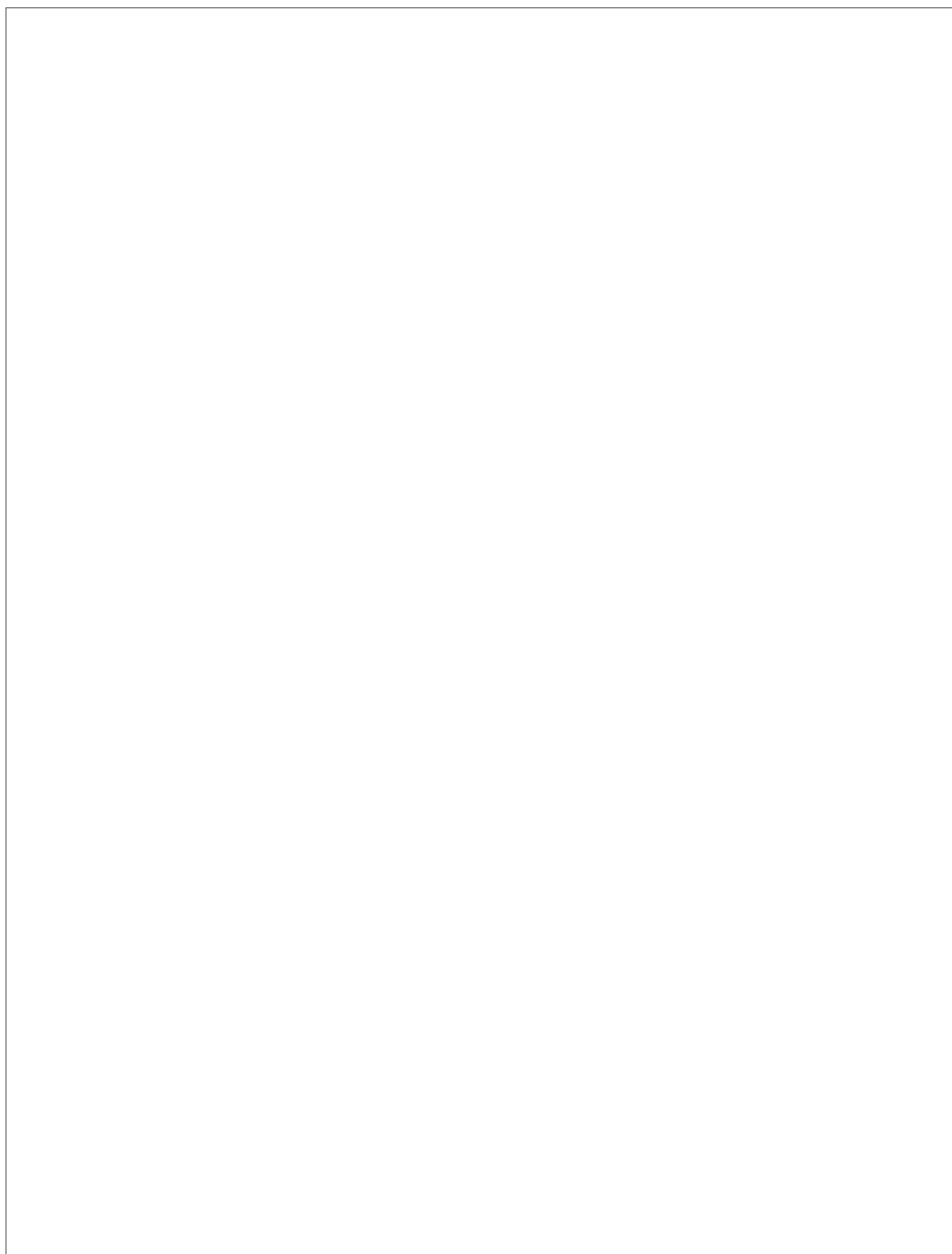


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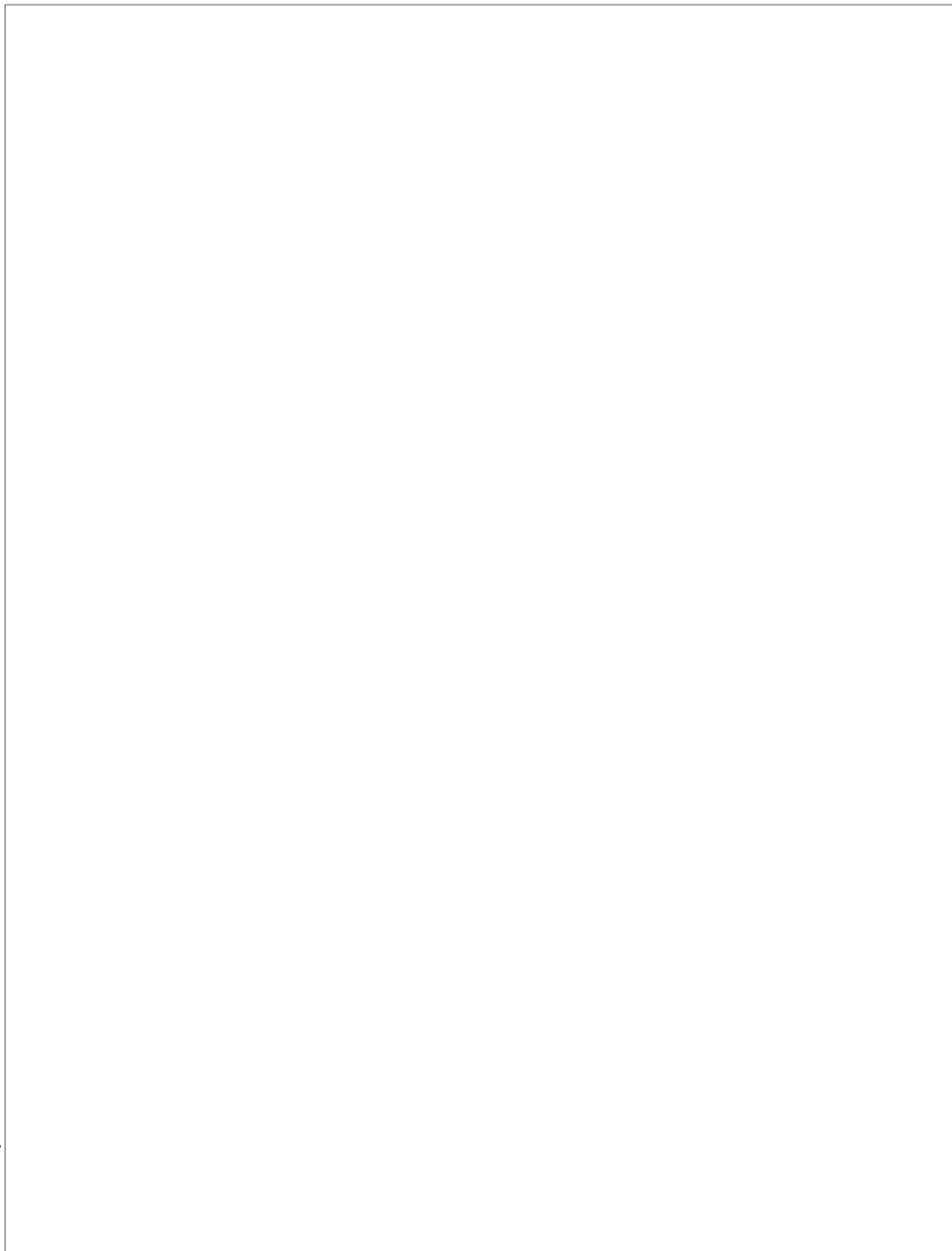


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~~Top Secret~~**BULGARIA: Government Threatens Student Strikers**

The Interior Ministry yesterday threatened to break up two-week-old student demonstrations against unfairness in the national elections earlier this month. The opposition Union of Democratic Forces (UDF) has thrown its support behind the demonstrations and has drawn crowds of 40,000 on each of the past two days. The strikers have called a news conference on Saturday to discuss their key demands: an open investigation of alleged electoral fraud, the resignation of the head of Bulgarian television, and a determination of authenticity of a videotape showing President Mladenov recommending the use of tanks against a demonstration last December.

Comment: The use of security forces would risk a violent confrontation with students; a backlash against the Bulgarian Socialist Party (BSP) probably would ensue in highly politicized Sofia and would set back efforts to attract Western support. The government is aware of the risks and may yet hold back. If it moves, it almost certainly will make every effort to avoid the violent tactics used in Romania. The UDF's support for the students indicates it is losing interest in legislative coexistence with the BSP and will press charges of electoral fraud and demands for new elections in some constituencies when the legislature meets on 10 July.

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West European Reliance on Soviet Natural Gas

The EC Commission has agreed to evaluate a Dutch proposal for a European Energy Community involving the USSR and the EC. The proposal, which calls for using Soviet natural gas in European pipelines as collateral for West European loans to the Soviets, underscores Western Europe's need for additional natural gas supplies and its capacity to store additional gas. The Soviets can currently export about 100 billion cubic meters (bcm) of gas per year to Western Europe by pipeline. Last year Austria, Finland, France, Italy, West Germany, and other countries imported 48 bcm of Soviet natural gas, or 18 percent of total regional gas consumption. Many experts expect Soviet gas exports to Western Europe to rise to almost 65 bcm or 20 percent of total consumption this decade as Switzerland, Turkey, and Greece become importers. West European countries will need substantially more gas supplies to meet demand increases expected by 2010.

EC Keeps Sanctions Against South Africa

West European leaders yesterday retained their economic bans against South Africa but showed support for President de Klerk's government in announcing they would begin lifting sanctions when Pretoria undertakes further major reforms. The UK and Portugal had urged that the EC immediately end economic restrictions, but Ireland indicated it would veto any attempt to lift sanctions until Pretoria has made fundamental changes. A draft statement being coordinated yesterday promised to increase assistance to South Africa's black community and to some 20,000 opposition exiles returning home.

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~~Top Secret~~**EC: Developing Soviet Aid Plan**

Despite the EC's decision at the Dublin summit to hold off on a large aid commitment to the USSR, the West Europeans probably will argue at the Houston summit for a joint Western plan to help the Soviet economy. The EC summit deferred action on a proposed immediate \$15 billion assistance package but agreed to have the EC Commission prepare a report by October on Soviet needs and on aid options. [redacted] EC members have agreed in principle to provide aid but are debating what conditions to attach.

Comment: Although the EC decision has reduced the chance of confrontation at Houston over Soviet aid, Bonn, Paris, and Rome are likely to press for transferring sponsorship of the EC study to the G-24 countries. Italian Foreign Minister De Michelis believes that US and EC participation are necessary to prevent the creation of a special German-Soviet relationship built in part on West Germany's recent \$3 billion export credit guarantee to the USSR. Further sharp deterioration in the Soviet economy, which the French and Germans believe possible in the next several months, could spur the Europeans to press ahead with their own aid package if they fail to persuade other G-24 nations to participate.

ZAMBIA: Price Reform Sparks Unrest

As many as 20 people have died and some 150 have been injured in rioting that began in Lusaka on Monday after the price of cornmeal, the staple of the Zambian diet, was doubled. President Kaunda yesterday called an emergency cabinet meeting as violence and looting continued. Military and police forces are on alert throughout the country, especially in the volatile Copperbelt region, which produces 93 percent of Zambia's foreign exchange earnings through copper mining. Demonstrations apparently have been confined to Lusaka.

Comment: Kaunda almost certainly is reluctant to reduce or rescind price increases, a key component of an economic reform program he hopes will lead to a much-needed IMF loan and other outside assistance. He broke with the IMF in 1986, after price increases led to riots in the Copperbelt. If violence continues, Kaunda may back down again to retain public support. In response to sharp popular criticism of his single-party rule, he is waging a heavyhanded campaign to intimidate proponents of multiparty democracy; he has called for a referendum on the issue later this year.

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~~Top Secret~~**In Brief****USSR**

- Increasingly assertive authorities in Soviet Azerbaijan have expelled from local Communist parties three Armenian leaders from violence-prone areas of secessionist Nagorno-Karabakh ... new confrontations with Armenia almost certain.

Europe

- Hungarian legislature yesterday voted unanimously to negotiate withdrawal from Warsaw Pact ... consistent with government's declaration at Pact summit that Budapest will quit before 1992 ... will not participate in Pact maneuvers this year.
- East German police killed Soviet soldier Monday after he took a family hostage ... will stimulate public animosity, probably further protests against Soviet troops.

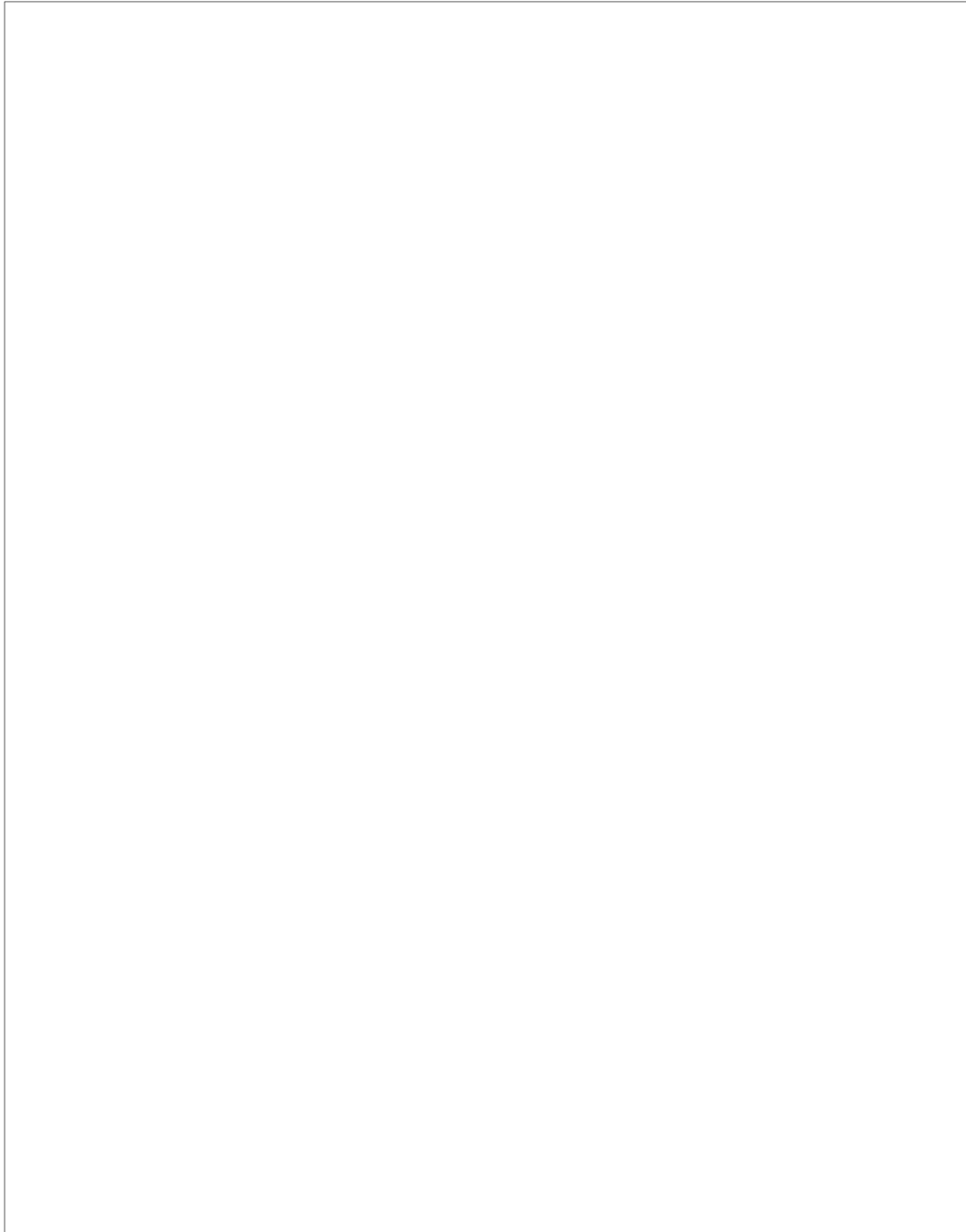
Americas

- Mulroney's Tory caucus has lost five Quebecers, none of Cabinet rank, since Canada's Meech Lake accord failed ... 57 remain ... majority probably safe at least until September, when many members may retire.

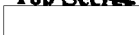
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- Arab League Tripartite Committee announced creation of \$2 billion international fund for reconstruction in Lebanon . . . no money pledged yet . . . President Harawi has received only sympathy on Gulf tour.

East Asia

- Press reports say Japan to unveil assistance package for East Germany, Bulgaria, Czechoslovakia, Yugoslavia at Houston summit . . . management training, environmental aid, investment credits likely . . . economic benefits minor.

- Traditional chiefs Monday approved draft constitution ensuring ethnic Fijian majority in legislature . . . clears way for interim government to promulgate . . . racial tension likely to grow as Indian-dominated opposition steps up criticism.

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Special Analysis

IRAN:

After the Earthquake

The economic reverberations of last week's earthquake will trouble Tehran long after rescue operations conclude. Politically, Iran's cautious response to the US aid offer suggests that factionalism over foreign policy persists and that President Rafsanjani is not likely to seek improved ties to the US soon.

The earthquake will drain resources from badly needed postwar development projects. Rebuilding housing and infrastructure could absorb several billion dollars worth of local currency, forcing Tehran to sharply reduce development spending elsewhere or to continue the inflationary print-and-spend monetary policy of recent years. Hopes of launching Rafsanjani's ambitious five-year reconstruction plan with higher oil earnings this year were already being dashed by softening world prices.

Iranians' outpouring of support for the regime's relief effort may turn to anger if Tehran does not maintain a vigorous rebuilding effort. The government's failure to provide assistance to several flood-ravaged provinces late last year sparked at least one major riot.

Foreign Aid a Two-Edged Political Sword

Spokesmen for the regime have welcomed foreign offers of assistance, including those from the US. Interior Minister Nuri, who heads the relief effort, on Monday praised the effectiveness of humanitarian aid from abroad and said it would be "sheer ungratefulness if all these efforts had been neglected."

Rafsanjani's opponents in the radical-controlled press, however, argue that Western aid is motivated by politics, not sympathy. They blame Washington for the Shah's squandering of resources and neglect of the northwestern region. One piece suggested that victims beneath the rubble were chanting "Death to America." Progovernment papers, and even one recognized as being more radical, have criticized such attacks as "narrow" and irresponsible.

Outlook

Most observers have been impressed by Tehran's initial relief effort, but the greater challenge for the regime lies ahead when returning

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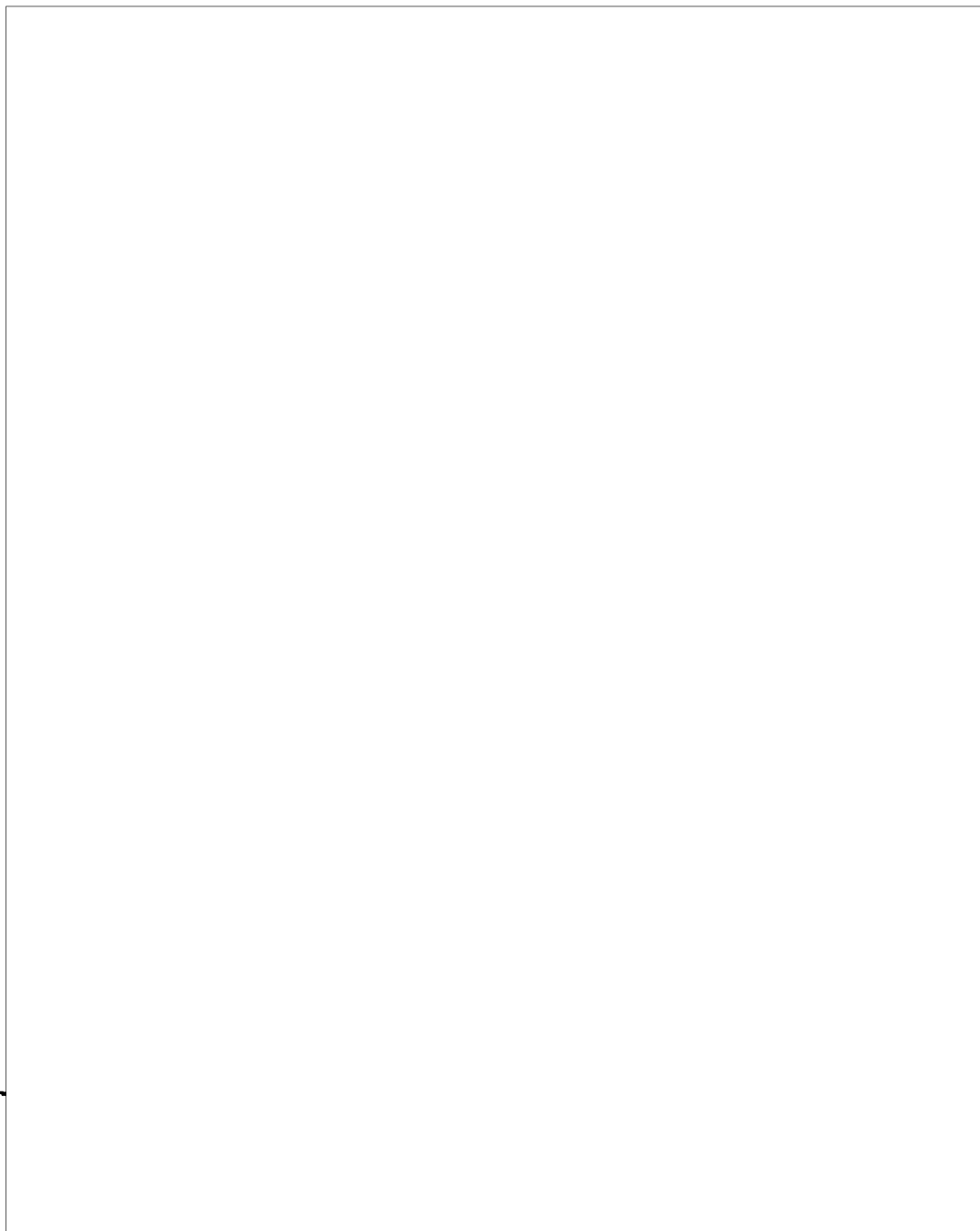
villagers find the government unable to provide adequate shelter, food, water, or medical support in time for winter. More broadly, the drain of earthquake relief will practically wipe out any prospect that living conditions for the average Iranian will improve by yearend.

Rafsanjani probably will use the urgent need for foreign earthquake aid to press his efforts to improve ties to the West and to attract foreign involvement in Iran's postwar reconstruction. His opponents are likely to use the fall session of the Consultative Assembly to restrict Rafsanjani from translating earthquake aid into foreign policy initiatives. Assembly members from the affected regions, some of whom may already have ideological grievances against the government, may use shortcomings in the relief effort against Rafsanjani.

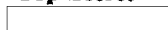
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Special Analysis

CHINA:

Waiting for Sanctions To Fall

The decision to release dissident Fang Lizhi was hard for China's leaders, who see him as one of their most dangerous opponents; they almost certainly believe the gesture will lead to suspension of the economic sanctions imposed on China last June.

China's central authorities last week told senior Communist Party members that Fang's release would help repair relations with the West, according to a Hong Kong press report. Beijing probably believed it was making only marginal headway in ending Western sanctions and needed to provide Japan a rationale for pressing at the Group of Seven summit in Houston next month for relaxation of restrictions on lending to China. Beijing also hopes the release will set a positive tone for Shanghai Mayor Zhu Rongji's tour of the US next month; he is the first prominent Chinese official to visit the US since the Tiananmen Square crackdown.

Japan's swift, generally positive reaction to Fang's release no doubt will gratify China's leaders; much of their effort to break Western sanctions has focused on Japan. Prime Minister Kaifu on Monday welcomed the decision, and Foreign Minister Nakayama said it established an extremely favorable environment for Japan to persuade the G-7 to agree to new lending to China.

Beijing views resumption of World Bank lending as critical to important infrastructure projects it cannot easily finance itself because of its budget deficit, a record \$7.8 billion last year. In particular, China wants to move ahead with large-scale construction projects to ease energy and transportation bottlenecks.

China's leaders probably are worried Fang's departure for the West might revitalize the overseas dissident community, which has been divided and ineffective.

A Hong Kong newspaper alleges the decision to release Fang was made by Deng Xiaoping with the support of General Secretary Jiang Zemin and Politburo member Li Ruihuan. Premier Li Peng, Vice President Wang Zhen, and Army political commissar Yang Baibing reportedly resisted. The lack of major disturbances in China on 4 June, the anniversary of the Tiananmen crackdown, may have convinced the hardliners this risk was acceptable. Beijing probably will continue to try to improve foreign relations, but it remains concerned about internal security and is unlikely to alter its human rights policies fundamentally.

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Views of Soviet Leaders on Speed of Market Reforms

The delay in moving toward a regulated market economy is likely to highlight splits in the leadership over how quickly to proceed. It will create opportunities for President Gorbachev to retake the initiative and put pressure on Premier Ryzhkov's government to accept more radical concepts.

Gorbachev endorsed an accelerated transition to a regulated market economy at the Russian Communist Party conference last Tuesday, but so far he has avoided using his presidential powers in favor of trying to build consensus. The presidential decrees he issues will indicate his willingness to take political risks in order to speed reform.

Ryzhkov has said publicly that, while there is no turning back to command-administrative methods, the country must not rush headlong into a market economy. Recent calls for his removal and the legislature's remand of his program are putting intense pressure on him to move faster.

State Planning Committee Chairman Maslyukov recently predicted his organization's future would be as a scaled-back regulatory agency like Japan's Ministry of International Trade and Industry. Maslyukov, a cautious reformer in the Ryzhkov mold, apparently is trying to portray himself as a progressive reformer. In addition to heading the commission overseeing revisions to the Ryzhkov program, he was the key economic official at the Washington summit and is rumored to be a possible successor to Ryzhkov.

Communist party secretary Ligachev in Monday's *Pravda* called for the public to choose between socialism and capitalism in a national referendum. Ligachev, who favors retaining public ownership of the means of production, has seized on the referendum as a tactic to undercut Gorbachev's policies and slow reform.

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Special Analysis

USSR:

Legislative Delay Leaves Economy Hanging

The Supreme Soviet's recent decision to remand the government's package of economic reforms and price increases shows a desire to move more quickly toward a market system and avoid responsibility for measures requiring consumer sacrifices. The package was seriously flawed, and the economy may ultimately benefit if the government heeds the Supreme Soviet's call for bolder action. The failure to enact retail price increases, however, denies the government a potentially powerful tool for stabilizing consumer markets and reducing the budget deficit. Until stronger action is taken, public uncertainty and apprehension of future hardships will dampen work incentives and contribute to growing social unrest.

The Supreme Soviet gave the government until September to prepare a detailed plan for developing markets and competition and postponed a decision on bread prices until then.

The legislature's resolution may yield a stronger program. It urged Gorbachev and the Council of Ministers to issue decrees encouraging private economic initiatives, promoting alternatives to state ownership, developing the banking system, breaking up monopolies, and curtailing the state bureaucracy.

Lost Opportunities

By itself, the failure to raise bread prices leaves the economy no worse off because the government proposed to fully compensate consumers for the increases, offsetting any savings achieved by reducing subsidies. Nevertheless, the failure to enact consumer price increases represents a lost opportunity with potentially high costs. Rapid growth in the public's money incomes is an important cause of instability in consumer markets. Price increases not offset by compensation would soak up substantial excess purchasing power and help reduce the budget deficit, a source of inflationary pressure. The Supreme Soviet has called on the government to reduce the deficit but has called for cuts only in investment, defense spending, and other outlays that do not directly affect consumers.

Next Steps

The Supreme Soviet's decision presses the government and Gorbachev harder to implement an effective reform program soon.

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The government has set up a commission on a regulated market economy to coordinate its response. The commission, headed by Deputy Premier Maslyukov, will include economists and enterprise managers and will consult with republic Supreme Soviets. [REDACTED]

Gorbachev's willingness to use his presidential powers could be critical to speeding the reform process. Possible decrees raising retail prices or encouraging private entrepreneurs would aggravate growing social unrest and entail substantial political risks. Other measures, such as breaking up large enterprises or dismantling ministries, could draw fire from entrenched interest groups but would be less controversial with the public. [REDACTED]

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